Litigating D&O Claims in the Modern Age: What's the Difference Between a Breach of Fiduciary Duty and Doing Your Job Really, Really Badly?

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The successful pursuit of claims against directors and officers of bankrupt companies is a complicated and multi-faceted challenge requiring a hybrid skill set possessed only by practicing trial attorneys with a solid understanding of bankruptcy and insurance law. As these experienced counsel can attest, even when dealing with a prima facie meritorious claim, thorough due diligence—both legal and factual—can make the difference between a favorable outcome and a satisfied client or, what legal scholars sometimes refer to technically as, a mess.

Before one even addresses the bankruptcy-specific issues, one must of course confront the general authorities around the duty of due care (which requires management to make decisions with reasonable diligence and prudence) and the duty of loyalty (i.e., acting in the best interests of the organization rather than oneself). A careful review of exculpation clauses and the legal authorities that may limit the scope of these duties is also essential. One must understand the entire universe of potential defendants in a D&O claim including sponsors, lenders, joint venture partners, and others whose nominees occupied board positions during the time periods preceding the bankruptcy.

For plaintiff's counsel the long list of bankruptcy-specific challenges often begins with questions of standing. Does the client creditor or a committee have standing to pursue D&O claims that at first instance belong to the estate (i.e., derivative actions)? The Delaware LLC Act, for instance, may cast doubt on whether a creditor or committee has the requisite standing to pursue such claims depending on the characteristics of the committee or creditor. If the answer is unclear, are there tactical and strategic choices around venue that can improve the odds?

An almost equally important question is whether any assets are likely to be available to satisfy a judgment. In many cases, the primary asset will be the proceeds of a directors and officers insurance policy claim. The potential value of such proceeds will depend not only on the face amount of the policy, but also on the interaction of a myriad of exclusions, including bankruptcy-specific exclusions, and on the success of other claims (i.e., the burning candle or wasting policy problem). A thorough understanding of the relevant policy and notice period(s), the availability of tail coverage, and the status of outstanding premiums are each essential.

Discovering and establishing the facts to support one's case can be challenging at the best of times and may be all the more so when access to documents, electronic records, or individuals with firsthand knowledge of historic events can be adversely impacted by the bankruptcy itself, including hurdles like operational restructuring (i.e., layoffs) and/or the cessation of operations. Obtaining access to privileged legal advice and opinions delivered to the company prior to bankruptcy can also be uniquely problematic. Effective and creative responses to these challenges, such as third-party discovery, can make the difference between success and failure.

The calculation of damages may also be complicated by the bankruptcy. For example, should the business be valued as a going concern, or does the fact of bankruptcy make liquidation the presumptive or baseline outcome? What is the appropriate measure of damages where it is alleged that the directors and officers resulted in a debtor becoming more deeply insolvent?

Those who practice and resolve cases against current and former directors and officers of bankrupt companies possess a unique skill set and knowledge base. Developing a better understanding of each of the considerations noted above will benefit any bankruptcy attorney whether they aspire to join the ranks of plaintiff or defense counsel or simply to better understand the dynamics at play in their cases.

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